



SUBJECT: BMA Financial Condition Assessment

TO: Committee of the Whole

FROM: Finance Department

Report Number: F-29-19

Wards Affected: All

File Numbers: 100-01

Date to Committee: July 8, 2019

Date to Council: July 15, 2019

Recommendation:

Receive the BMA Financial Condition Assessment Report dated June 2019; and
Approve the Capital Reserve fund Financial Policy to target a consolidated reserve fund balance of 2% of the city's total asset replacement value; and
Direct the Director of Finance to undertake an update to the City of Burlington's Financial Condition Assessment every four years with each new term of Council.

Purpose:

- An Engaging City
- Good Governance

The purpose of this report is to provide Committee and Council with a summary of the Financial Condition Assessment for the City of Burlington prepared by BMA Management Consulting Inc. (copy provided under separate cover). The consultant will be providing a presentation to the Committee of the Whole.

Background and Discussion:

A financial condition assessment of the City has been undertaken and completed by BMA Management Consulting Inc. (BMA) and presents an analysis of the City's current financial health and position, observations and review of the city's existing financial policies and comparison to the last financial condition assessment, which was completed in 2015.

Financial Condition Assessment

The intent of the BMA report is to provide a systematic process to monitor and evaluate a municipality's financial outlook and performance. The report provides an analysis of the city's financial position using several recognized financial indicators, which are structured into the following three sections:

1. Growth and Socio-Economic indicators
2. Municipal Levy, Property Taxes and Affordability
3. Financial Position

The analysis includes a comparison of Burlington's results against recognized industry standards, provides historical trend information, as well as a comparison to seven peer municipalities, being Oakville, Milton, Markham, Whitby, Oshawa, Kitchener and St. Catharines. The same municipalities were also used in the previous study as comparators.

For each of the three sections, this report summarizes in a table the financial indicators for Burlington based on the consultants' review. In addition, a comparison to the 2015 results is provided to denote changes. The summary tables reflect the City's financial position as follows:

- **Positive:** an alignment with the City's goals, policies and industry standards. At or above the targeted performance indicator and/ or trending positively
- **Neutral:** a situation where the City is not yet fully aligned with the City's goals, policies and industry standards. No target indicator and/ or stable trend.
- **Caution:** indicates that a trend has changed from a positive direction and is going in a direction that may have an adverse effect on the City's financial condition and/ or trending negatively. This is also used to indicate that, although a trend may appear to be positive, it is not yet in conformance with the City's goals, policies or industry standards

Below are some highlights of BMA's evaluation and a summary of reserves and reserve funds that the City uses to assist with long term financial stability and planning.

1. Growth and Socio-Economic Indicators – Summary

Growth and socio-economic indicators encompass various economic and demographic characteristics including population, employment, household income, assessment and construction and business activities.

Indicator	2018 Result	Comments	2015 Result
Unemployment rate	Positive	Aligned with full employment targets of 6% or less. Continues to be below the Provincial average.	Positive
Construction activity	Positive	Good mix between residential/ non-residential development but lower than peer average.	Positive
Assessment growth	Neutral	Growth is lower than the peer average	Neutral
Household income	Positive	Higher than the average of municipal comparators	Positive
Assessment Composition	Positive	Good mix between residential/ non-residential assessment, proportions remained consistent over time.	Positive
Richness of assessment base	Positive	Strong assessment base upon which to raise taxes	Positive

Highlights

- Over the five-year period 2013-2017 the City had lower than average construction activity per capita in comparison to the other municipalities in the comparator group
- Residential / non-residential construction activity is a 58/42 split (over the last five years), representing a good balance between these two types of development
- Residential/non-residential split of assessment of approximately 80/20 respectively indicates that the city has a well-diversified assessment base to support municipal programs
- The City's weighted assessment per capita is the third highest in the survey, an indicator of the community's ability to pay for services and support municipal programs
- Assessment increase in the City was lower than the peer average (consistent with trends identified in the relative growth of construction activity), which may pose to be an ongoing challenge

2. Municipal Levy, Property Taxes and Affordability – Summary

This section provides an overview of the cost of municipal services (property taxes) in the City and affordability compared to peer municipalities.

Indicator	2018 Result	Comments	2015 Result
Municipal Levy per \$100,000 Weighted Assessment	Positive	Levy is lower than peer average	Positive
Property Taxes on a Residential (bungalow)	Positive	Below the comparator average	Positive
Property Taxes on a Two Storey Residential House	Positive	Below the comparator average	Positive
Property Taxes on a Multi-Residential High-Rise Unit	Warning	Above the comparator average	Neutral
Property Taxes on Neighborhood Shopping per sq. ft.	Warning	Above the comparator average	Warning
Property Taxes on an Industrial Building per sq. ft.	Warning	Above the comparator average	Warning
Residential Affordability	Positive	Third lowest in the comparator average	Positive

Highlights

- The Municipal tax burden tends to be low for all property classes except for multi-residential, commercial shopping and industrial in comparison to the other municipalities in the comparator group
- The levy per \$100,000 of weighted assessment is less than the average of the municipal comparator group, reflecting a lower level of municipal spending in relation to the assessment base.
- Property taxes as a percentage of household income in Burlington are the third lowest in the survey average of municipal comparators, reflecting residential affordability
- The city has roughly the same level of tax spending as the peer average on a per capital basis

3. Financial Position – Summary

Reserves and reserve funds when used in conjunction with debt policies are a critical component of a municipality's long-term financial plan and financial health.

Reserves and reserve funds provide tax rate and cash flow stability when the City is faced with unforeseen or uncontrollable events. It ensures cash flows are sustained and allows for internal financing for temporary or one-time expenditures. Furthermore, these funds provide the City flexibility to manage debt levels and allows for planning future liabilities.

The City has four categories of reserves and reserve funds;

- Stabilization Reserves and Reserve Funds
- Capital Reserve Funds
- Corporate Reserves and Reserve Funds
- Program Specific Reserves and Reserve Funds

The city also maintains reserve funds for Local Boards, which were established in response to specific programs for each board. Their operating surpluses are used to fund their respective reserve funds.

Stabilization Reserves & Reserve Funds

These types of reserves and reserve funds are used to mitigate the risk of raising taxes or reducing service levels due to temporary revenue shortfalls or unanticipated expenditures. It is restricted to unforeseen or temporary events, which can include the previous year's operating deficits.

Overall, the target balance for the consolidated stabilization reserve funds (excluding Building Permit Stabilization Reserve Fund) is set at 10%-15% of the City's own source revenues. As of 2018, the consolidated balance of these reserve funds is below target at 8.9%. Furthermore, in the 2019 budget, there was \$2.4 million of commitments approved, which was partially offset with a provision amount of \$1.6 million from 2018 operations.

The city maintains seven stabilization reserve funds as summarized below including relevant financial policies.

Reserve Fund	Policy/ Description
Contingency	<ul style="list-style-type: none"> Used to address confidential legal and human resource matters
Severe Weather	<ul style="list-style-type: none"> To mitigate financial strain caused by severe storms and weather activity Target balance is equal to one year's expenditure requirements. A minimum balance of 25% of the five-year average of winter maintenance costs should be maintained (adjusted for inflation) City has a balance of \$3.9 million above the target balance of \$1.5 million, recognizing greater frequency of climate change impacts
Tax Stabilization	<ul style="list-style-type: none"> Used to address tax stability by funding operating deficits and one-time expenditures Funded through operating surpluses
Building Permit Stabilization	<ul style="list-style-type: none"> To stabilize building permit revenues and expenditures, which can vary from year-to-year based on development activity level Target balance of 163% of total direct operating expenditures When the reserve fund exceeds the target and remains above the ceiling for two years or more, the city will undertake a review to determine whether the balance should remain above the target City has a balance of \$2.8 million slightly below the target balance of \$2.9 million
Planning Fee and Engineering Fee Stabilization	<ul style="list-style-type: none"> Used to stabilize Planning and Engineering revenues, which can vary from year-to-year based on level of development activity Funded by revenue surpluses and used to fund revenue shortfalls when they occur
Commodity Stabilization	<ul style="list-style-type: none"> To alleviate the financial impact of uncontrollable or unexpected fluctuations in commodity costs

Capital Reserve Funds

As stated in the City's Strategic Plan, all city infrastructure will be maintained in a state of good condition. Annual contributions that are consistent and predictable to capital

reserve funds is vital for the future rehabilitation and replacement of assets to be able to meet this goal.

BMA recommends that as a general principle a consolidated target for capital reserve funds should be with a minimum balance of 2% of the total asset replacement value. Based on the City’s total asset replacement value of \$3 billion, this equates to an estimated \$60 million. As of 2018, the City’s uncommitted consolidated year-end balance in capital reserve funds is approximately \$40.7 million, below the intended target. Furthermore, the consolidated balance in capital reserve funds has decreased by 11% over the last five years.

To ensure sufficient funds exist for future asset replacement, staff recommends adopting the following Capital reserve fund policy;

Recommended Policy	
Capital Reserve Funds (Consolidated)	<ul style="list-style-type: none"> • Target balance is equal to 2% of the total asset replacement value. • Currently equates to approximately \$60 million

Other existing policies regarding capital reserve funds are summarized below:

Existing Assets (Infrastructure Renewal):

- Capital reserve funds will be used;
 - to fund the replacement or refurbishment of existing assets through calculated annual contributions from the operating budget and other sources based on replacement costs and guided by the city’s asset management financing plan
 - All assets will be maintained at a level that protects capital investment and minimizes future maintenance and replacement costs.

New Assets (Growth)

- Capital reserve funds will be used;
 - to fund new assets related to growth or program enhancements by developing a multi-year forecast to identify the impact of new facilities and infrastructure
- As new assets are acquired, contributions will be made based on annual amortization and lifecycle costing
- If new assets are funded through debt, annual contributions to the reserve funds will be made once the debt repayments have been completed.

Repayment to Capital Reserve Fund

- Any new assets financed from Capital Reserve Funds will be repaid, including interest, from future operating budgets over the life of the asset for its replacement (depending on affordability)

Corporate Reserves & Reserve Funds

These reserve and reserve funds are used to manage current costs that will be transferred to future generations, as the City incurs liabilities that do not have to be paid immediately. Reserve funds in this category include the Employee Accident, Benefits and Insurance reserve funds.

Contributions to Corporate Reserve/Reserve Funds should take into consideration the liability associated with these funds. A sufficient budget allocation is required to fund the WSIB costs and employee benefits so that the Employee Accident Reserve Fund and Benefits Reserve Fund can eventually be replenished to cover the liabilities. (Based on affordability)

Reserve Fund	Policy/ Description
Employee Accident and Benefits Reserve Funds	<ul style="list-style-type: none"> • Used to fund WSIB claims, post-retirement benefits and other related expenses • Combined associated liabilities and reserve fund balance as of 2018 is \$20.7 million and \$6 million respectively • City should gradually address the liabilities over a period of 5-10 years and by ensuring annual contributions are reflective of historical and forecast requirements
Insurance Reserve	<ul style="list-style-type: none"> • Replenished from annual current budget contributions • Provides for Insurance premiums and payment of deductibles not covered by city policies and helps stabilize annual fluctuations

Program Specific Reserves & Reserve Funds

Program specific funds are established from time to time by Council based on needs of the community. A financial plan will be prepared for all Program Specific Reserves/Reserve Funds to ensure that there are adequate funds to sustain the program requirements. Plans will be reviewed annually in conjunction with the budget process or as conditions change.

Some examples are the Community Heritage, Culture, Forestry and numerous Parks & Recreation related reserve funds.

Use	Spending from any Program Specific Reserves/Reserve Funds in any one year will not exceed the uncommitted balance in the reserve fund at the end of the preceding year
Closure	Upon conclusion of program specific projects, recommendations will be made to close the Program Specific Reserves/Reserve Funds and transfer any remaining balance to a Reserve(s) with the greatest need or as permitted by legislation

Development Charge (DC) Reserve Funds

Development charges will be applied to the full extent permitted by legislation. Currently, there are seven DC reserve funds under the city's existing by-law for transportation, storm drainage, fire, transit, library, parks and recreation, and development related studies.

Use	Spending from Development Charges reserve funds for capital projects directly related to growth as approved in the city's development charges background study.
Funding	On a consolidated basis, Development Charge Reserve Funds must maintain a positive balance
Borrowing	Borrowing internally first between growth related development charge reserve funds and then external debt as a last resort based on the growth-related debt policy Where debentures are issued on behalf of development charges, the City will separately track the repayments to be recovered from future DC revenues (including interest)

Debt Management

The city's debt policy limits the total debt charges as a percentage of net revenues to 12.5% (provincial legislated limit is 25%). As of March 31, 2019, the City's total debt charges as a percentage of own source revenue is estimated to be 10.3% (as per report F-14-19 – Quarterly Status Report).

Types of Debt	
Tax Supported (TSD)	<ul style="list-style-type: none"> • Debt charges are repaid from the city’s annual operating budget • Debt limit shall not exceed 10% of city’s own source revenues
Non-Tax Supported (NTSD)	<ul style="list-style-type: none"> • Debt charges are repaid from revenues and fees from user groups • Issued on behalf of community groups • Excluded from the City’s guidelines for tax supported debt
Special Circumstances (SCD)	<ul style="list-style-type: none"> • Debt charges are repaid annually from the Hydro Reserve Fund • Excluded from the City’s guidelines for tax supported debt • The city is no longer issuing further waves of SCD • To date the city has issued \$47 million in SCD

The City makes every effort to minimize the impact of debt-servicing costs and manage future debt levels. Debt financing should be considered only as a last resort for asset replacement and be limited to specific project types and employed as a means of financing projects related to:

- New capital initiatives
- Projects tied to third-party matching funds
- Project costs not recovered from development charges
- Projects where the cost of deferring expenditures exceeds debt servicing costs
- Projects where the asset life extends beyond the term of the debt

Debt Policy Guidelines	
Term of Debt (Length)	<ul style="list-style-type: none"> • The term will not exceed the useful life of the asset • The preferred term of debt is 10 or 15 years, taking into consideration debt repayment impact
Monitoring	<ul style="list-style-type: none"> • The City will monitor all forms of debt and report on a quarterly basis
Retirement of Debt	<ul style="list-style-type: none"> • As debt charges decline, the City will apply savings to accelerate achievement of full lifecycle costing of the City’s infrastructure

As per the BMA report, a municipality’s financial position is defined as the total fund balances, which includes equity in business enterprises, less the amount to be

recovered in future years associated with long-term liabilities. Burlington’s financial position has remained stable over the last five years and is above the peer average.

Indicator	2018 Result	Comments	2015 Result
Discretionary Reserves/Reserve Funds as a % of Taxation	Warning	Relatively flat over the last 5 years and not keeping up with inflation	Warning
Stabilization Reserve Funds	Warning	Below the target policy levels	Positive
Other Capital Reserve Funds	Warning	Downward trend, with policies in place to help address the infrastructure gap	Warning
Vehicle & Equipment Reserve Funds	Warning	Downward trend, with policy in place to increase contributions	Positive
Transit related Reserve Funds	Neutral	No target indicator, balance relatively stable	Positive
Corporate Reserves & Reserve Funds	Warning	Liabilities increasing at a faster rate than reserve balances	Warning
Program Specific Reserves & Reserve Funds	Neutral	Several new reserves created that align with the City’s strategic directions	Neutral
Local Boards Reserve Funds	Neutral	Available to support local boards	Neutral
Debt Outstanding per \$100,000 of weighted assessment	Positive	Relatively low levels of debt and below the peer comparator group	Positive
Debt to Reserve ratio	Positive	Healthy ratio and better positioned than the peer average	Positive
Financial position	Positive	Relatively flat position and slightly higher than municipal comparator average	Positive
Taxes Receivable	Positive	Well within the recommended range and lowest of peer comparator group	Positive

Highlights

- The City's reserves and reserve funds (excluding obligatory reserve funds) have increased by 15% since 2014. The increase is offset by decreases across capital reserve funds (11%)
 - Discretionary reserves (including commitments) as a percentage of taxation has remained relatively flat and is slightly above the survey average
 - The consolidated 2018 stabilization reserve fund balance as a percentage of own source revenues (excluding the Building Permit reserve fund) is below the targeted range of 10-15%, and currently at 8.9%
 - Unfunded liabilities continue to exist in the city's corporate reserves. Since liabilities do not come due at the same time, it is reasonable to have some unfunded liabilities, yet gradually address the liabilities to ensure it does not continue to grow
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Financial Matters:

The Financial Health Report prepared by BMA Management Consulting Inc. was completed at a cost of \$20,000, which was funded by Financial Management Services.

Connections:

The financial condition assessment continues to provide a framework to enhance financial policies for the City of Burlington. The City is proactive in financial planning, developing forecast models and utilizes several tools which provides council with surety that financial policies are adhered to, including;

- Annual operating and capital budget and forecast
 - 20-year simulation of forecasted budget drivers
 - Quarterly Financial status report
 - Semi annual budget performance
 - Annual capital closure
 - Long-term financial plan
 - Asset management financing plan
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Public Engagement Matters:

The results of this study will be shared with the Treasurer/Director of Finance from each of the seven comparator municipalities and the Region of Halton.

Conclusion:

This report provides an overview of the City of Burlington's Financial Condition Assessment as prepared by BMA Management Consulting Inc. which uses several recognized financial indicators to monitor and evaluate the City's financial outlook and performance.

As the City has made some improvements to the financial indicators, there continues to specific reserve and reserve fund trends that reflect a warning indication. Some key areas that the City will need to monitor is its ability to maintain and replace capital assets and continue, if not increase, contributions to certain reserve funds to meet established targets. This will improve the City's sustainability and flexibility while minimizing risk and ensures the City's financial and service commitments to residents and stakeholders are met.

Respectfully submitted,

Ann Marie Coulson

Manager of Financial Planning and Taxation

905-335-7600 x7655

Appendices:

- A. BMA Report – June 2019 Financial Condition Assessment

Report Approval:

All reports are reviewed and/or approved by Department Director, Director of Finance and Director of Legal. Final approval is by the City Manager.